

## Audit Committee Roundup

# Adapting to New Economic Realities

**Recession-related risks prevail among Audit Committee members.**

By Henry R. Keizer

With the prospect of continued economic slowdown in 2008, audit committees are paying particular attention to the recession-related risks that are facing their companies. At the same time, they are taking a hard look at their company's risk-management processes—understanding the quality of the company's risk intelligence—and many are focusing on the tone at the top and culture of the organization as critical to effective risk management.

These topics were at the forefront of conversations at the recent Annual Audit Committee Issues Conference, during which more than 140 audit committee members from around the country discussed the oversight challenges that they will likely face in the coming year. In fact, when asked to identify their top oversight concerns for 2008, audit committee members overwhelmingly identified “recession-related” risks followed by “risk intelligence” and “tone at the top, culture, and incentives.”

While the effects of a slowing economy will vary by company and by industry, a glance at *The Wall Street Journal* or *Financial Times* any day of the week suggests that recession-related risks should remain high on audit committee agendas for 2008. From my perspective, it is imperative for audit committees to be catalysts in helping ensure effective board oversight of management's efforts to address these risks.

In conversations I have had

with members of audit committees, general business uncertainty and liquidity are often cited as key business risks to be managed, in addition to the financial, strategic, marketing, and human resources risks associated with an economic downturn. In particular, they emphasize that audit committees need to understand their company's debt situation, including debt maturities, access to capital markets, and the impact of the recession on the company's supply chain and distribution channels. There's also a need for CFOs to communicate with credit-rating agencies about how the company is managing these critical risks.

Another theme resonating throughout the panel discussions during the conference was the important role the audit committee plays in reinforcing an appropriate tone at the top, particularly during a business downturn, when there is tremendous pressure on management to maintain the company's performance, reduce costs, and meet expectations.

In addition to these recession-related risks, another concern on the minds of audit committee members is the status of risk management generally; chief among these concerns, the adequacy of risk inventories and assessments. As a result, many audit committees and boards are asking management to reassess the status of their company's risk-management processes and identify potential gaps. The audit committee can assist in such a reassessment by:

- Understanding how rigorous management's processes are to identify and assess the risks to the business and how risk information is collected and by whom.

- Ensuring that risk reports provided to the board and audit committee are useful and meaningful.

- Clarifying who is managing each risk, what board committee is overseeing the risk, and ensuring that executives who manage key risks are communicating appropriately with the standing committees charged with oversight.

- Understanding the caliber of the company's risk-reporting and monitoring systems.

On the other side of the coin, several audit committee members cautioned against “losing sight of the forest for the trees.” The purpose of risk management is not the “process,” but to help understand significant risks to the business.

While a periodic assessment of the company's risk-management processes may be appropriate, audit committees should be sensitive to the concern that essential to any effective risk-management system is the company's tone at the top, culture, and incentive systems. These “Capital R Risks,” if unattended, may pose the greatest risk of all to the enterprise.

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